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## Viewing cable 07RIYADH313, ENERGY WORKING GROUP MEETS IN RIYADH, DISCUSSES

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**Understanding cables**
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| Reference ID | Created | Released | Classification | Origin |
|---|---|---|---|---|
| 07RIYADH313 | 2007-02-14 15:04 | 2011-08-30 01:44 | CONFIDENTIAL | Embassy Riyadh |

Appears in these articles:
http://www.mcclatchydc.com/2011/05/25/114759/wikileaks-saudis-often-warned.html

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VZCZCXRO7777
PP RUEHDE RUEHDIR
DE RUEHRH #0313/01 0451504
ZNY CCCCC ZZH
P 141504Z FEB 07
FM AMEMBASSY RIYADH
TO RHEBAAA/DEPT OF ENERGY WASHINGTON DC PRIORITY
RUEHC/SECSTATE WASHDC PRIORITY 4366
INFO RUEHZM/GULF COOPERATION COUNCIL COLLECTIVE PRIORITY
RUEHHH/OPEC COLLECTIVE PRIORITY
RUEHBJ/AMEMBASSY BEIJING PRIORITY 0338
RUEHMO/AMEMBASSY MOSCOW PRIORITY 0673
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RUCPDOC/DEPT OF COMMERCE WASHDC PRIORITY
RUEAIIA/CIA WASHDC PRIORITY
RHEBAAA/DEPT OF ENERGY WASHINGTON DC PRIORITY
RHEHNSC/NSC WASHDC PRIORITY
RUEKJCS/SECDEF WASHDC PRIORITY

C O N F I D E N T I A L SECTION 01 OF 05 RIYADH 000313

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DOE PASS TO KHARBERT, AHEGBURG, GPERSON
CIA PASS TO TCOYNE

E.O. 12958: DECL: 02/14/2017
TAGS: EPET ENRG EINV SA
SUBJECT: ENERGY WORKING GROUP MEETS IN RIYADH, DISCUSSES
INTERNATIONAL OIL MARKET

Classified By: AMBASSADOR JAMES OBERWETTER FOR
REASONS 12958 1.4 B, D, AND E

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Summary
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¶1. (SBU) Assistant Secretary of Energy for Policy and International Affairs Karen Harbert and Prince Abdulaziz bin Salman al-Saud, Assistant Minister for Petroleum Affairs, Ministry of Petroleum and Mineral Resources (MOPMR) convened an Energy Working Group (EWG) in Riyadh on February 3. The Energy Working Group is part of the Secretarial-level Strategic Dialogue. The meeting was warm and cordial, as the senior DOE, State and MOPMR officials meet regularly. Both parties forecast the international oil market will move into a period of slower growth in the medium term, with non-OECD nations continuing to drive oil market growth. The parties agreed the non-conventional oil sources are becoming a modest but more important part of the world's energy portfolio. The interlocutors expressed concern with the international oil companies (IOCs's) emphasis on enhanced oil recovery (EOR) and other technological improvements at the apparent expense of financing new exploration. The Saudis critiqued both alternative fuel proponents and peak oil theorists, cautioning against the high cost of biofuels and assumptions that economic policy can overcome fundamental pricing challenges. In light of supplier volatility in many regions in the world, the U.S. delegation emphasized the value the USG places on reliable suppliers such as Saudi Arabia.

¶2. (C) Assistant Secretary Harbert's meetings in Riyadh February 3 - including with Petroleum Minister Naimi (septel) - were well timed and responsive to Saudi policy-level concerns with the USG's increasingly stress on alternative fuels, and on the openness of the US investment climate to a Saudi proposed multi-billion dollar refinery expansion in Texas. End Summary.

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Reviewing the Energy Working Group
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¶3. (SBU) Technical presentations during the EWG highlighted oil market dynamics, forthcoming projects and opportunities in the upstream and downstream in both the U.S. and Saudi Arabia, and new U.S. energy policies with regard to alternative energy and fuel specifications. The parties also discussed climate change and U.S.-Saudi energy cooperation. This is the first of four cables reviewing the EWG discussions, covering:

a. Forecasts and discussion of the international oil market
b. Saudi plans for upstream and downstream expansion
c. Climate change
d. Cooperation between the U.S. and Saudi Arabia, with a focus on the Joint Oil Data Initiative (JODI)

¶4. The following teams participated in the EWG:

Visiting USG Delegation:
--DOE Assistant Secretary for Policy and International Affairs Karen Harbert;
--DOE Deputy Assistant Secretary Alan Hegburg;
--DOE Director, Office of African and Middle Eastern Affairs George Person;
--DOE, Energy Information Administration, Director of

Integrated Analysis and Forecasting Glenn Sweetnam;
--Department of State, Director International Energy and Commodity Policy Office, Stephen Gallogly.

Economic Counselor Silverman, DOE Deputy Director for Electricity Delivery and Energy Reliability Alvarez, Energy Attache Ross, and Economic Officer Pacheco also participated in the EWG for Embassy Riyadh.

The Saudi Working Group team consisted of:

--HRH Prince Abdulaziz bin Salman al-Saud, MOPMR, Assistant Minister for Petroleum Affairs;
--Dr. Majid Al-Moneef, MOPMR, OPEC Governor for Saudi Arabia;
--Dr. Ibrahim al-Muhanna MOPMR, Advisor to the Minister and Director of Public Relations;
--Dr. Mahmoud Al-Osaimy, MOPMR, Advisor to the Minister;
--Dr. Ahmed Al-Ghamdi, Advisor to the Minister;
--Advisor to the Minister on Climate Change Dr. Mohammed Al-Sabban;
--Abdulelah Abdulaziz Albuniyan, MOPMR;
--Yasser Mufti, Saudi Aramco, Corporate Advisor on Energy Outlook, Corporate Planning;
--Dr. Mohammed Yahya Al-Qahtani, Saudi Aramco, Manager, Reservoir Description and Simulation Department;
--Salahaddin Dardeer, Saudi Aramco, Engineering Superintendent, Riyadh Refinery.

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Mature Economic Cycle Creates Cyclical Slowdown;
Demand Growth Continues in non-OECD, China
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¶5. (SBU) Saudi Aramco's Yasser Mufti kicked off a series of technical presentations with the MOPMR's analysis of the international oil market. (Note: Saudi Aramco employees conducted all of the Saudi presentations, highlighting the tremendous depth and substance Saudi Aramco brings to the MOPMR's service. End note.) For 2007, the MOPMR forecasts the world economy's entry into a mature phase of the economic cycle will impact the international oil market, creating a cyclical slowdown for the foreseeable future. Mufti noted interest rates appear to be on the upswing worldwide, which will dampen increased demand in the oil sector. He stated the non-OECD countries, particularly China, will continue to be the crucial driver for increased oil consumption, with transport and feedstock key to their increased demand. Largely due to growth in the non-OECD market, the MOPMR forecasts increased demand for crude oil at 1.4-1.6 million barrels per day (mbpd) per year. Projecting over the next seven years, MOPMR forecasts up to 3 mbpd in demand uncertainty.

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China and the Middle East Continue
Strong Demand Profile
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¶6. (SBU) While noting China would continue to drive demand growth, Mufti described China's energy market as fragmented, with a huge urban-rural divide, and great regional variance. Gas oil and gasoline are the strongest growth components, driven by transport and the industrial sectors. Urban areas could reach saturation in the foreseeable future in absorbing additional petroleum products, but a predominantly impoverished population in the interior will remain locked out of the growth in energy consumption enjoyed by city dwellers. Due to a large population bulge at the bottom of the age pyramid, Mufti stated the Middle East, and Saudi Arabia in particular, will be among the strongest areas of demand growth. Aerial views of Riyadh from 1972 to 2000 vividly highlighted the city's dramatic growth and accompanying increase in energy demand.

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Non-OPEC Supply Growth Forecast at 1.2 mbpd/year;
Industry Faces Serious Expenditure Challenges
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¶7. (U) Mufti then moved on to discuss supply side issues. In the non-OPEC states, OECD oil production declines are evident as fields mature. Growth in deepwater and non-conventional oil production has eclipsed production in the former Soviet Union (FSU). The MOPMR forecast non-OPEC supply growth 1.2 m/bpd per year in the medium term, with possible risks to supply growth including project delays, country risk, and normal production declines in maturing fields. Mufti reiterated the constant refrain heard at every oil industry event: the industry is stretched by expenditure costs, particularly for scarce rigs and manpower. The recent price environment first stimulated interest in enhanced oil recovery (EOR) projects. However, he noted, we have not yet seen the price environment drive much new exploration.

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Non-OPEC Moving Beyond Conventional Oil, but
Economics of Alternative Fuels Remains a Challenge
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¶8. (U) Mufti reviewed the MOPMR's analysis of alternative fuels, noting the resources and processes employed for alternative fuels were generally not new. He forecast output of alternative fuels to more than double in the next ten years, with a compounded annual growth rate of 8.8%. He included tar sands, extra heavy oil, gas-to-liquids (GTL), coal-to-liquids (CTL), oil shale, ethanol, and biodiesel within his forecast. Mufti highlighted the high capital costs of alternative fuels. He pegged the capital cost to maintain a daily barrel of production capacity for alternative fuel at $25,000-$60,000, stating that Saudi Arabia crude costs only $5,000-$10,000 to maintain the same daily capacity. Mufti stated some European biodiesel cost up to $120,000 per daily barrel of capacity. He attributed large capital cost variances to factors such as feedstock prices, technological efficiency, emissions, and fiscal incentives. Moving on to ethanol, Mufti's analysis indicated the $60/barrel for crude oil was the breakeven point for U.S. corn-based ethanol.

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Growth in OPEC Oil Supply: 4.5 mbpd in Three Years
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¶9. (SBU) Mufti said the MOPMR expects OPEC supply to increase 4.5 mbpd in the next three years. Iraqi output will be driven by it internal ability to supply oil, not external market requirements. Natural gas liquids (NGL) and gas output will also rise. There will significant upstream development in all of the "OPEC 10" nations (all OPEC members minus Iraq). Mufti forecast steady but moderate oil production growth until the end of the decade. He highlighted OPEC's spare oil production, indicating it will continue to grow.

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Trade Increasingly Meeting Global Energy Needs
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¶10. (U) The global economy is witnessing increased reliance on trade to meet its energy needs. Mufti noted ten years ago, the global economy imported 53% of its oil, but now imports 61%. New supply areas are geographically remote from major demand centers, and mature oil provinces in developed countries continue to experience production declines. These factors, coupled with limitations on refining capacity in major demand centers, continue to drive increased trade in oil. Mufti indicated the MOPMR expects growth in the oil trade will be three to four times the rate of global GDP growth.

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Oil Increasingly Integrated into the
Global Financial Markets
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¶11. (SBU) Mufti described the explosive growth in crude oil

futures since 2003, noting about 2 billion paper barrels are now in trade. The Saudi analysis indicated a link between higher oil prices and the influx of investor funds into the oil markets. He remarked that as commodity markets become increasingly mature, investors tended to view oil futures as just another asset class, ripe for investing. He described the forward curve for oil futures as "weirdly shaped," stating "a lot of money believes prices will be higher going out." As the oil futures markets play an increasingly large role in setting world oil prices, he remarked his team was now obtaining better insights into prospective oil prices from banks than from those working in the real oil sector, such as refiners.

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Saudis Cast Aspersions on Biofuel and Peak Oil
Proponents; Policy Won't Wean the Public Off Oil
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¶12. (SBU) In a presentation aimed at both proponents of alternative and biofuels, as well as peak-oil theorists such as Matt Simmons, Mufti concluded by quoting from a 2002 article, "A Half Century of Long-Range Energy Forecasting Errors." The authors identified a number of common errors in long-range energy forecasting, such as underestimating the size of world energy resources, underestimating the role of prices and the adaptability of markets, substantial overestimate in primary energy consumption, strong influence of events and trends at the time of the forecast, overzealous assumptions regarding changing people's behavior, and assumptions that economic policy can overcome economics.

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EOR: Making the Most of What you Have; but
Declines in Exploration Worry EWG Participants
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¶13. (SBU) Both U.S. and Saudi EWG interlocutors expressed concern with a precipitous fall in new exploration. Mufti stated oil service company Schlumberger has sold off its seismic unit, and is no longer engaged in exploration work. Instead, Schlumberger contacts have told him all of their clients have now contracted with Schlumberger for EOR activities. Assistant Secretary Harbert noted the percentage of IOC budgets devoted to exploration fell from 30% to 10% from 2000 to 2005. DAS Hegburg remarked the key to exploration was, "access, access, access," and, with the closure of Russia, Venezuela, and other nations to the IOCs, there were simply fewer opportunities to access new fields.

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EIA Market Forecast: Non-OECD Outstrips
OECD Oil Consumption by 2015
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¶14. (U) EIA Director Sweetnam presented the EIA forecast on oil market growth. He projected OECD oil consumption to grow at 1 percent, with non-OECD consumption growing at 3 percent. By 2015, the non-OECD nations will surpass OECD nations in total oil consumption. Sweetnam noted the EIA modeled oil demand forecasts for three economic growth scenarios: a reference case at 3.8% global economic growth, a high growth scenario at 4.6% annual global growth, and a low growth scenario at 3.1% growth. Underscoring the difficulty of planning for oil consumption growth over the long term, Sweetnan told us the difference in projected demand between the high and low growth scenarios was 50 million barrels of oil equivalent.

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Growth in Coal Creates Environmental Challenge
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¶15. (SBU) Sweetnam noted the EIA expects less oil in the world energy mix as coal, gas, and alternative fuel consumption increases. The rise in natural gas prices in tandem with oil prices during recent years will lead more of the developing world, especially India and China, to turn to

coal. Assistant Secretary Harbert remarked that 80% of the world's new coal plants were being built in India and China, a significant environmental challenge, given their failure to date to adopt clean coal technology. China, she noted, was firing up one new coal power plant every week. She added that China currently had 9 million passenger cars on the road, a figure expected to grow to 100 million by 2030, "a figure we think is too low," she remarked.

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Deliverability of Oil is Focus for U.S. Delegation
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¶16. (C) Moving onto non-OPEC oil growth, Assistant Secretary Harbert remarked, "the question in Russia is, will

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investment occur?" She stated the conditions for energy investment there have taken a dramatic turn for the worse. She indicated in Venezuela, the government of Hugo Chavez was increasing social spending by 100% per year, while decreasing petroleum investment by 8% a year - a trend with inevitable results for Venezuelan production. The USG delegation conveyed the value the USG placed on Saudi Arabia's reliability as a supplier. In discussing suppliers such as Nigeria which experienced difficulty in meeting their contract terms, or Venezuela, which may experience such problems in the future, Sweetnam highlighted the market impact on reliable suppliers. He concluded, "reliable suppliers such a Canada and Saudi Arabia will have a bigger call on their oil."

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Comment
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¶17. (C) The relationship between DOE, State and the MOPMR is long-standing and very solid. However, the Saudis have been frustrated with recently-announced U.S. programs and public statements designed to accelerate research into alternative fuels. Mufti countered by emphasizing that consumers won't be weaned off of oil unless other options are price competitive, and appraising that USG policy won't alter market fundamentals. The technocrats who run Saudi Aramco understand there is room for biofuels and other alternatives in a growing U.S. and world energy portfolio. Nonetheless, the political leadership within MOPMR kicks back against the USG saying so in too public a fashion.

¶18. (U) DAS Hegburg has cleared this message.

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